In the Supreme Court of the United States

OCTOBER TERM, 1969

No. 408

LOUISE M. SCUDDER, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. A1-A12) is reported at 405 F. 2d 222. The order of the court of appeals denying a rehearing (Pet. A13-A17) is reported at 410 F.2d 686. The findings of fact and opinion of the Tax Court (Pet. A18-A27) are reported at 48 T.C. 36.

JURISDICTION

The judgment of the court of appeals was entered December 30, 1968, and on May 8, 1969, the court

of appeals denied petitions by the taxpayer and by the Commissioner for rehearing. (Pet. A16.) The petition for a writ of certiorari was filed July 30, 1969. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether a wife filing federal income tax returns jointly with her husband is liable under Section 6013(d) of the Internal Revenue Code of 1954 for taxes and fraud penalties resulting from her husband's failure to report income he received from various investments and properties, although the wife had no knowledge of the unreported items of income? [1]

STATUTE INVOLVED

Internal Revenue Code of 1954:

SEC. 61. GROSS INCOME DEFINED.

(a) *General Definition.*—Except as otherwise provided in this subtitle, gross income means all income from whatever source derived, including (but not limited to) the following items:

* * * *

(2) Gross income derived from business;

(3) Gains derived from dealings in property;

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[1] For convenience, Frank E. Scudder will be referred to herein as petitioner's husband, although he and petitioner were divorced in 1963.

(13) Distributive share of partnership gross income;

* * * *

[26 U.S.C. 61.]

SEC. 6013. JOINT RETURNS OF INCOME TAX BY HUSBAND AND WIFE.

* * * *

(d) *Definitions.*—For purposes of this section—

* * * *

(3) if a joint return is made, the tax shall be computed on the aggregate income and the liability with respect to the tax shall be joint and several.

[26 U.S.C. 6013.]

SEC. 6653. FAILURE TO PAY TAX.

* * * *

(b) *Fraud.*—If any part of any underpayment (as defined in subsection (c)) of tax required to be shown on a return is due to fraud, there shall be added to the tax an amount equal to 50 percent of the underpayment. In the case of income taxes and gift taxes, this amount shall be in lieu of any amount determined under subsection (a).

* * * *

[26 U.S.C. 6653.]

STATEMENT

During the years 1954 through 1958, petitioner was married to Frank E. Scudder, they lived in

Owensboro, Kentucky, and they filed joint federal income tax returns for these years with the District Director of Internal Revenue at Louisville, Kentucky. (Pet. A20.)

Throughout this period, Mr. Scudder was manager of Owensboro Liquor Company, a wholesale liquor company which petitioner and her five sisters owned as partners (R. 32a).[2] Without the permission or knowledge of petitioner or her sisters, Mr. Scudder withdrew more than $303,000 from the partnership, disguising the withdrawals as loans or travel advances (Pet. A2). Because he concealed the withdrawals from petitioner and the accountants who prepared their tax returns, the funds withdrawn were not reported as income on the returns (R. 37a, 39a).

In addition to the partnership withdrawals, Mr. Scudder received income from 1954 through 1958 of slightly more than $8,000 from a number of investments and properties of which petitioner had no knowledge (R. 6a-7a, 29a-30a; Pet. A2). This income also was concealed from petitioner and the accountants who prepared the returns and was not reported for tax purposes. (R. 39a).

Petitioner conceded in the Tax Court that her husband received the partnership funds and the other items of unreported income from his various investments and properties. (R. 27a-29a). The Tax Court held (Pet. A25-A26) that petitioner's husband did not deliberately deceive her to induce her to sign the

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[2] "R." refers to the appendix to the taxpayer's brief in the court of appeals.

joint returns; that his concealment of the partnership funds and the other income did not constitute fraud so as to invalidate her signature on the returns; and that, in accordance with Code Section 6013(d), she was jointly and severally liable with her husband for taxes and penalties relating both to the partnership funds and the other income.

A divided court of appeals held (Pet. A13, A16) that regardless of whether her husband's withdrawals from the partnership were characterized as embezzlement or as unauthorized loans, the fact that he allegedly embezzled money from her, causing the partnership books to reflect his withdrawals as loans or travel advances, indicates fraud, trickery and duress, so as to exempt her from liability for taxes and penalties relating to the unreported partnership funds.[3] The court unanimously held, however, that petitioner was liable for taxes and penalties relating to the unreported income from Mr. Scudder's investments and properties, the majority reasoning being that Mr. Scudder's failure to include this income in the joint returns was not equivalent to fraud, trickery and duress which led the court to exempt petitioner from liability with respect to the illegally withdrawn partnership funds.

ARGUMENT

The decisions below, holding petitioner liable for taxes and penalties for 1954 through 1958 on unreported taxable income which her husband derived

[3] The Commissioner will not seek further review of this holding.

from his investments and properties, is correct and embodies a proper application of established principles. Petitioner conceded (R. 26a-30a) that the greater portion of the deficiencies determined by the Commissioner in connection with her husband's investments and properties was correct. She also stipulated that she signed joint returns with her husband for these taxable years (R. 32a).

Section 6013 of the Internal Revenue Code of 1954, *supra*, p. 3, provides that if a joint return is made, the liability with respect to the tax on the aggregate income shall be joint and several. The tax due on a joint return extends to a tax deficiency resulting from unreported income. *O'Dell* v. *United States*, 326 F. 2d 451 (C.A. 10); *Sullivan* v. *Commissioner*, 256 F. 2d 4 (C.A. 5). The legislative history of Section 6013 indicates that Congress did not intend any limitation on the joint liability to protect innocent spouses (see H. Rep. No. 1860, 75th Cong., 3d Sess., pp. 29-30 (1939-1 Cum. Bull. (Part 2) 728, 749), and that deficiencies, penalties and interest in respect of a joint return may be collected from either spouse or both of them. (See Report of a Subcommittee of the Committee on Ways and Means, House of Representatives, 75th Cong., 3d Sess., on Proposed Revision of the Revenue Laws (1938), pp. 49-50. See also *Federbush* v. *Commissioner*, 34 T.C. 740, affirmed *per curiam*, 325 F. 2d 1 (C.A. 2); *Kann* v. *Commissioner*, 210 F. 2d 247 (C.A. 3), certiorari denied, 347 U.S. 967.)

Petitioner contends (Pet. 6-7), as she did on petition for rehearing below (Pet. A15), that since the Sixth Circuit held that she was not liable for taxes

and penalties resulting from unreported income derived from Mr. Scudder's illegal withdrawals from the partnership, she should not be held liable for taxes and penalties relating to her husband's unreported income from investments and properties. There is no basis for this contention.

The Court below correctly held (Pet. A15) that its holding exempting petitioner from paying tax on money Mr. Scudder illegally withdrew from the partnership does not extend to income derived from his investments and properties, even though some of the investments undoubtedly were made with funds withdrawn from the partnership. See *Howell* v. *Commissioner*, 175 F. 2d 240 (C.A. 6). In exempting petitioner from liability with respect to the partnership withdrawals, the Sixth Circuit made clear that it was persuaded by the unique facts to hold on equitable principles, rather than the literal words of the statute, that petitioner as an innocent wife should not be held liable for taxes and penalties on money illegally taken or embezzled from her by her husband. It found (Pet. A8, A14) that his conduct was equivalent to fraud, trickery, and duress, which has been held to exempt a spouse from liability, even though a joint return is signed. *Furnish* v. *Commissioner*, 262 F. 2d 727 (C.A. 9).

As to the taxes and penalties here involved, resulting from Mr. Scudder's unreported income from investments and properties, there is nothing in the record from which the Sixth Circuit could find fraud, trickery, or duress, so as to exempt petitioner from liability. Petitioner incorrectly asserts (Pet. 6) that

the fraud, trickery, and duress of Mr. Scudder related to the validity of the execution of the joint returns, so as to exempt her from liability for all deficiencies. The Sixth Circuit did not hold that the joint returns were invalid. Indeed, in granting petitioner exemption from liability as to more than $303,000 of the total unreported income of approximately $311,000, it treated her more than fairly. Judge McCree pointed out in his opinion (Pet. A16-A17) that the court could have held, in the light of her admission that her husband's illegal withdrawals constituted embezzlements, that under Code Section 6013(d)(3) she was jointly and severally liable for all deficiencies, having voluntarily signed the joint returns. See *James* v. *United States*, 366 U.S. 213. It was only the harsh result of circumstances, in which an innocent wife would be held liable for deficiencies on unreported income which had been illegally taken or embezzled from her by her husband, that caused the Sixth Circuit to apply equitable principles rather than the literal wording of the statute. Petitioner has no reason to complain of such treatment. However, regardless of whether the Sixth Circuit properly applied the judicial exception to joint and several liability of co-signers to a federal tax return in connection with Mr. Scudder's illegal withdrawals from the partnership, its position with regard to the other omitted income is unassailable.

There is no question here of administrative importance, as asserted (Pet. 5, 7), nor any conflict or other reason to warrant further review.

CONCLUSION

For the reasons stated, the petition for a writ of certiorari should be denied.

Respectfully submitted.

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AUGUST 1969.

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